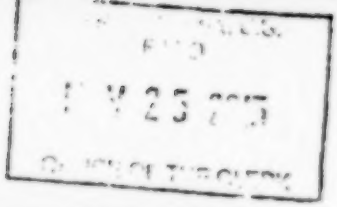

No. 14-1458

IN THE

Supreme Court of the United States

MHN GOVERNMENT SERVICES, INC., AND
MANAGED HEALTH NETWORK, INC.,

Petitioners,

v.

THOMAS ZABOROWSKI, ET AL.,

Respondents.

ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

BRIEF FOR PETITIONERS

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QUESTION PRESENTED

The Federal Arbitration Act (FAA) provides that an arbitration agreement shall be enforced "save upon such grounds as exist at law or in equity for the revocation of any contract," 9 U.S.C. § 2. California law applies one rule of contract severability to contracts in general, and a separate rule of contract severability to agreements to arbitrate. The arbitration-only rule disfavors arbitration and applies even when the agreement contains an express severability clause. Its application in this case conflicts with binding precedent of this Court and with opinions of four other courts of appeals.

The question presented is whether California's arbitration-only severability rule is preempted by the FAA.

CORPORATE DISCLOSURE STATEMENT

Petitioner MHN Government Services, Inc. is a wholly owned subsidiary of MHN Services. MHN Services is a wholly owned subsidiary of Petitioner Managed Health Network, Inc. Petitioner Managed Health Network, Inc. is a wholly owned subsidiary of Health Net, Inc., a publicly held corporation.

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OPINIONS BELOW

The district court's opinion (Pet. App. 12a-30a) is published at 936 F. Supp. 2d 1145 (N.D. Cal. 2013). The Ninth Circuit's divided decision (Pet. App. 1a-11a) is not published in the *Federal Reporter*, but is available at 601 F. App'x 461 (Dec. 17, 2014).

JURISDICTION

The Ninth Circuit denied rehearing and rehearing en banc on February 9, 2015. Pet. App. 31a. Subsequently, Justice Kennedy extended the time for filing a petition for a writ of certiorari to June 10, 2015. This Court has jurisdiction pursuant to 28 U.S.C. § 1254(1).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

The Supremacy Clause of the Constitution, Art. VI, Cl. 2, provides:

> This Constitution, and the Laws of the United States which shall be made in Pursuance thereof ... shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.

Section 2 of the Federal Arbitration Act, 9 U.S.C. § 2, provides:

> A written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.

INTRODUCTION

In enacting the Federal Arbitration Act (FAA) in 1925, Congress sought to eliminate the "longstanding judicial hostility to arbitration agreements that had existed at English common law and had been adopted by American courts, and to place arbitration agreements upon the same footing as other contracts." *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 24 (1991). The FAA not only "declared a national policy favoring arbitration," but further "withdrew the power of the states to require a judicial forum for the resolution of claims which the contracting parties agreed to resolve by arbitration." *Southland Corp. v. Keating*, 465 U.S. 1, 10 (1984).

At its core, the FAA demands that States end their longstanding hostility to arbitration agreements and treat arbitration agreements like all other con-

tracts—no better, no worse. Section 2 declares that arbitration agreements "shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. § 2. States and their courts must therefore "place arbitration agreements on an equal footing with other contracts." *AT&T Mobility LLC v. Concepcion*, 131 S. Ct. 1740, 1745 (2011). No special rules—whether expressed by state statute or common law—may be applied to disfavor agreements to arbitrate. Equally, facially neutral rules cannot be applied in a manner that is hostile to arbitration. Thus, purportedly generally applicable contract defenses, such as unconscionability, are preempted if they are applied in a manner that subjects arbitration clauses to special scrutiny or that imposes heightened standards on arbitration agreements. *Id.* at 1747-48.

The California courts have demonstrated a long history of hostility to arbitration. California courts often mouth the proper FAA mandate, claiming that "under both federal and California law, arbitration agreements are valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." *Armendariz v. Found. Health Psychcare Servs., Inc.*, 6 P.3d 669, 755 (Cal. 2000) (footnote omitted). They say that all contracts are equal in their eyes. *Id.* at 777. These hollow assurances of equality are, however, reminiscent of George Orwell's *Animal Farm*. There, the central commandment that "all animals are equal" was later revised to expose the reality that under the regime of Leader, Comrade Napoleon, "all animals are equal, but some animals are more equal than others." George Orwell, Animal Farm 192 (1945). Similarly, in California, "all

contracts are equal," but arbitration agreements are "less equal" than other contracts.

The present case highlights the problem. In *Armendariz*, the California Supreme Court, while denying hostility to arbitration agreements, held that if an agreement to arbitrate contains "more than one" provision deemed "unlawful" by a court, that by itself is valid grounds for refusing to enforce the entire agreement. 6 P.3d at 696-97. The court explained: "[M]ultiple defects" in an "arbitration agreement" "indicate a systematic effort to impose arbitration ... not simply as an alternative to litigation, but as an inferior forum that works to the employer's advantage," and thus allow a court to find that the entire agreement is per se "permeated by an unlawful purpose." *Id.*

This rule applies only to agreements to arbitrate. No comparable rule exists for other contracts. Outside the context of arbitration agreements, no California rule holds that multiple unconscionable or illegal provisions in any contract indicate a systematic unlawful purpose and allow a court to refuse severance. To the contrary, outside of the context of arbitration, California courts express an overwhelming preference for contract enforcement. The courts strain to sever unenforceable terms where there is, otherwise, a meeting of the minds. Not so with the "less equal" agreements to arbitrate. They may simply be deemed irreparably tainted and held void.

California courts even apply the *Armendariz* multiple-defects rule where, as here, the parties agree to sever unenforceable terms. *Armendariz* thus

creates, and California courts routinely apply, a special legal rule for agreements to arbitrate that does not apply to contracts generally and that is hostile towards arbitration. That is precisely what § 2 of the FAA prohibits. This Court should reject that rule and the hostility to arbitration that it reflects. That arbitration agreements must be treated as equals to other contracts and respected by state courts is not simply an empty motto, but a directive of controlling federal law that must be respected by the California courts in word and in deed. The Supremacy Clause demands nothing less.

STATEMENT OF THE CASE

Petitioners Create The Military & Family Life Consultant Program.

In 2004, the U.S. Department of Defense (DoD) recognized the necessity for additional counseling services to support active duty service members and their families, who were struggling under the effects of extended and repeated deployments to Iraq and Afghanistan. JA156-57. To help address that need, DoD entered into contracts with Petitioner Managed Health Network, Inc., and subsequently its affiliate, Petitioner MHN Government Services (MHN).[1]

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[1] Managed Health Network, Inc., a behavioral health subsidiary of Health Net. Inc., partners with a nationwide provider network of over 55,000 licensed practitioners and 1,400 hospitals and care facilities to deliver clinically based workplace solutions to improve productivity for its clients. *See* https://www.mhn.com/content/about-us, incorporated by

Together, DoD and MHN "established a program to provide short-term, situational, problem-solving non-medical counseling services" designed to address issues that arise "within the military lifestyle and help Service members and their families cope with the normal reactions to the stressful/adverse situations created by deployment and reintegration." JA156. The program does not replace medical counseling services offered by DoD. Rather, it augments "existing military support services and meet[s] emerging needs" for active duty service members and their families. JA157.

DoD and MHN originally piloted the Military & Family Life Consultant Program (Program) to support families of soldiers in the 1st Armored Division. JA156. The Program quickly expanded around the world, and is currently run through the Office of the Secretary of Defense and the DoD's Office of Family Policy. JA157. Pursuant to its contracts with DoD, MHN partners with licensed clinical practitioners, credentialed by MHN. JA158. The practitioners join the Program to offer service members and their families access to support for "dealing with relationships, crisis intervention,

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reference in Respondents' complaint, JA32. MHN Government Services operates under several government contracts and partners with the providers in its network to provide access to "a broad range of behavioral health services to Active, Guard and Reserve service members and their families as well as to Veterans." *See* https://www.mhngs.com/app/aboutus/about_us.content, also incorporated by reference in Respondents' complaint, JA31.

stress management, family issues, parent-child communications," and family separations and reunions due to deployments. JA157-58. The support furnished by the Program "is an integral part of ... assur[ing] that personal and family issues do not detract from operational readiness." JA158.

The settings in which practitioners serve can vary widely. JA169. Some engagements are "on demand" and last no more than a few days, while others are rotational, with rotations up to 90 days through military bases around the world. JA167-77.

To qualify to participate in the Program, practitioners must meet the same credentialing requirements as those who participate in MHN's commercial provider network. JA203-04. This includes having a graduate degree and a valid state license as an independent behavioral health care practitioner. JA250-51, 255. Providers eligible for network participation are psychologists, social workers, professional counselors, marriage family therapists, and registered nurses with psychiatric specialties. JA251.

Respondents Contract With MHN To Serve As Independent Contractors.

Respondents Thomas Zaborowski and Vanessa Baldini each entered into separate contracts with MHN to serve as subcontractors eligible to perform work for the Military & Family Life Consultant Program. Pet. App. 12a. Respondent Zaborowski is a licensed psychologist

and clinical social worker. Prior to contracting with MHN, he was providing independent consulting services to mental health providers. JA264, 274. He had previously served in supervisory roles in various mental health facilities, providing leadership, education and training, and administration. JA274.

Respondent Baldini is a Board Certified Marriage and Family Therapist. Prior to contracting with MHN, she had her own private counseling practice. JA284, 290.

To participate in the MHN network, both Zaborowski and Baldini reviewed and signed a Provider Services Task Order Agreement. Pet. App. 33a-60a. The Agreement provides that Respondents "shall deliver or arrange" "short term, situational, problem solving non-medical counseling support services" as detailed in "Task Orders" to be issued by MHN, depending on the needs of the DoD. Pet. App. 33a.

The Task Orders set forth the terms and conditions of the proposed engagements. Upon receipt of a Task Order, Providers have two business days in which to accept or decline the specific engagement. Pet. App. 39a. For example, Mr. Zaborowski received a Task Order for a rotation in Fort Riley, Kansas from May 31, 2011 until August 5, 2011 for which he would be paid up to $42,110. JA105-06.

In their contract with MHN, Respondents agreed to maintain professional liability insurance in

the amount of $1 million, and to ensure that "any and all subcontractors" they hired to fulfill the specific Task Orders were similarly insured. Pet. App. 34a-35a. The contract specifically defines the nature of the relationship between Respondents and MHN: "MHN and Provider are independent contractors in relation to one another and no joint venture, partnership, employment, agency or other relationship is created by this Agreement." Pet. App. 52a. In addition, "[n]either of the parties hereto, nor any of their respective officers, agents or employees shall be construed to be the officer, agent or employee of the other party." *Id.*

As part of the contract with MHN, both Zaborowski and Baldini separately agreed to arbitrate any disputes that might arise under the contract. Captioned "**Mandatory Arbitration**" in bold underlined text, and written in the same typeface and typesize as the rest of the contract, the arbitration clause provides, in full:

> **Mandatory Arbitration**. The parties agree to meet and confer in good faith to resolve any problems or disputes that may arise under this Agreement. Such negotiation shall be a condition precedent to the filing of any arbitration demand by either party. The parties agree that any controversy or claim arising out of or relating to this Agreement ... or breach thereof, whether involving a claim in tort, contract or otherwise, shall be settled

by final and binding arbitration in accordance with the provisions of the American Arbitration Association. The parties waive their right to a jury or court trial. The arbitration shall be conducted in San Francisco, California. A single, neutral arbitrator who is licensed to practice law shall conduct the arbitration. The complaining party serving a written demand for arbitration upon the other party initiates these arbitration proceedings. The written demand shall contain a detailed statement of the matter and facts supporting the demand and include copies of all related documents. MHN shall provide Provider with a list of three neutral arbitrators from which Provider shall select its choice of arbitrator for the arbitration. Each party shall have the right to take the deposition of one individual and any expert witness designated by another party. At least thirty (30) days before the arbitration, the parties must exchange lists of witnesses, including any experts (one each for MHN and Provider), and copies of all exhibits to be used at the arbitration. Arbitration must be initiated within 6 months after the alleged controversy or claim occurred by submitting a written demand to the other party. The failure to initiate

> arbitration within that period constitutes an absolute bar to the institution of any proceedings. Judgment upon the award rendered by the arbitrator may be entered in any court having competent jurisdiction. The decision of the arbitrator shall be final and binding. The arbitrator shall have no authority to make material errors of law or to award punitive damages or to add to, modify or refuse to enforce any agreements between the parties. The arbitrator shall make findings of fact and conclusions of law and shall have no authority to make any award that could not have been made by a court of law. The prevailing party, or substantially prevailing party's costs of arbitration, are to be borne by the other party, including reasonable attorney's fees.

Id. at 55a-57a.

Additionally, the contracts signed by Respondents contain an express severability clause. Captioned "**Severability**," the clause is written in the same typeface and typesize as the rest of the contract. Pet. App. 53a. It provides that if "any provision of this Agreement is rendered invalid or unenforceable ... the remaining provisions of this Agreement shall remain in full force and effect." *Id.*

The District Court Permits Respondents To Ignore Their Arbitration Agreement And File A Putative Class-Action Lawsuit In Court.

Despite the "**Mandatory Arbitration**" provision, Respondents filed a putative class-action lawsuit in district court against Petitioners, alleging violations of the Fair Labor Standards Act and various state laws. JA18-104. Specifically, the complaint alleged that Military & Family Life Consultants (MFLCs) should have been classified as employees, not independent contractors, and that, as employees under the Fair Labor Standards Act, they were entitled to overtime pay. JA21-22.

Consistent with the terms of the Agreement, Petitioners moved to compel arbitration. Respondents opposed. Applying California law, the district court concluded that the arbitration agreement was procedurally unconscionable because it was a contract of adhesion, MHN was in a "superior bargaining position to the individual MFL Consultants," and the arbitration agreement was not "set apart from the rest of the agreement in any way." Pet. App. 17a-19a. The district court also held that multiple provisions in the arbitration agreement were substantively unconscionable. Pet. App. 19a-28a. First, the court concluded that the provision requiring that "[a]rbitration ... be initiated within 6 months after the alleged controversy or claim occurred" was unconscionable. According to the court, the provision did not give Respondents enough time to discover that they were being treated as independent contractors instead of employees, Pet. App. 20a-21a. The court so held even though the Agreement Respond-

ents signed spells this out explicitly, Pet. App. 52a-53a.

The court also deemed the arbitrator selection provision unconscionable because it read the provision to unduly favor MHN. Pet App. 21a. Next, the court found that, even though Respondents were suing for more than $75,000, potential responsibility for the standard American Arbitration Association ("AAA") $2600 filing fee was unconscionable because it was more than "seven times greater" than the $375 filing fee in the Northern District of California. Pet. App. 23a-24a.

The court also deemed the Agreement's fee-shifting provision unconscionable because it did not mirror federal or state laws applicable to employees (despite the fact that it was not established that Respondents were employees) and "could be disproportionately burdensome to plaintiffs." Pet. App. 24a-25a. Finally, the court deemed the punitive damages restriction unconscionable, Pet. App. 25a-26a, even though the Fair Labor Standards Act does not provide for punitive damages, *see Brooklyn Sav. Bank v. O'Neil*, 324 U.S. 697, 707 (1945) ("the liquidated damage provision is not penal in its nature"), and only plaintiffs from Kentucky and North Carolina requested punitive damages at all. *See* JA86, 96-97

Though Respondents did not challenge the agreement's severability clause, the district court ignored the clause altogether and refused to sever the purportedly unconscionable provisions. The district court observed that, under California law, a court may decline a request to sever when the contract "is

permeated by unconscionability." Pet. App. 29a (internal quotation marks omitted). The court noted, however, that under *Armendariz*, when the contract at issue is an arbitration agreement, "[t]he finding of 'multiple unlawful provisions' allows a trial court to conclude that 'the arbitration agreement is permeated by an unlawful purpose'" and to therefore refuse to enforce the agreement in its entirety. *Id.* (quoting *Armendariz*, 6 P.3d at 697). Without any examination of whether or how the unenforceable terms truly permeated the agreement or whether there was still a meeting of the minds reflected in the remaining terms, the district court invalidated the entire arbitration agreement. *Id.* at 30a.

A Divided Ninth Circuit Panel Affirms.

A divided panel of the Ninth Circuit affirmed. The majority of the panel agreed that the arbitration agreement was procedurally unconscionable, and multiple provisions were substantively unconscionable. Pet. App. 2a-4a. It also upheld the district court's denial of severance. According to the majority, "[u]nder generally applicable severance principles, California courts refuse to sever when multiple provisions of the contract permeate the entire agreement with unconscionability." Pet. App. 5a. Like the district court, the panel majority relied on a California case that held: "An arbitration agreement can be considered permeated by unconscionability if it contains more than one unlawful provision .... Such multiple defects indicate a systematic effort to impose arbitration ... not simply as an alternative to litigation, but as an inferior forum that works to the [stronger party's] advantage." *Samaniego v. Empire*

Today, LLC, 140 Cal. Rptr. 3d 492, 501 (Cal. Ct. App. 2012) (alteration in original, internal quotation marks and citations omitted), *cited in* Pet. App. 5a.

Judge Gould dissented. He noted that two provisions were "arguably not unconscionable and apparently entered into in good faith." *Id.* at 10a, n.1. In any event, Judge Gould would have held that "[t]he reasoning in *Armendariz* that multiple unconscionable provisions will render an arbitration agreement's purpose unlawful has 'a disproportionate impact on arbitration agreements' and should have been preempted [by the FAA]." *Id.* at 8a (quoting *Concepcion*, 131 S. Ct. at 1747).

According to Judge Gould, "*Concepcion* and its progeny should create a presumption in favor of severance when an arbitration agreement contains a relatively small number of unconscionable provisions that can be meaningfully severed and after severing the unconscionable provisions, the arbitration agreement can still be enforced." *Id.* Applying the appropriate and arbitration-neutral test, Judge Gould found that severance should have been granted, and Respondents held to their basic promise to arbitrate rather than litigate. Judge Gould even included a redline mark-up of the arbitration agreement, *id.* at 8a-10a, demonstrating graphically that "if all the unconscionable provisions of the arbitration agreement, as determined by the district court and affirmed by th[e] panel, were severed ... the remainder of the arbitration agreement can still be enforced, and the district court need not assume the role of contract author." *Id.* at 8a (internal quotation marks omitted).

SUMMARY OF THE ARGUMENT

I. The FAA was enacted to end judicial hostility to arbitration and require all courts to enforce arbitration agreements according to their terms. Section 2 declares that arbitration agreements "shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. § 2.

At its core, the FAA demands that states impose no greater requirements on the enforceability of arbitration agreements than they do on other contracts. This Court has thus held that § 2 preempts arbitration-specific rules, or state-law rules that single out arbitration agreements and are hostile to them. The same is true when courts apply generally applicable contract defenses, such as unconscionability, in ways that subject arbitration clauses to special scrutiny or that impose heightened standards on arbitration agreements.

This Court has accordingly struck down state-law rules that impose special barriers on the enforcement of arbitration agreements or assess the enforceability of arbitration provisions according to rules that do not apply to contracts generally. It is irrelevant whether the state law rule that treats arbitration differently arises in the legislature or in a state court. Instead, only generally applicable contract defenses, that are applied in the same way for agreements to arbitrate as for contracts in general, survive § 2.

II.A. California courts apply a more stringent

rule to severing unconscionable or illegal terms in arbitration agreements than they do to severing unconscionable or illegal provisions in contracts generally. Like the laws of most states, California law expresses an overwhelming preference for contract enforcement. California law generally prohibits a court from voiding a contract unless the entire purpose of the contract is unlawful. Thus, California courts normally strain to enforce the lawful contractual provisions to which the parties agreed, while severing only those provisions found to be unlawful. Moreover, for contracts generally, California courts respect express severability clauses, reflecting the parties' intent to enforce their agreement even if individual terms are held unenforceable.

B. In stark contrast, California courts have long applied a different rule, favoring the nonenforcement of agreements to arbitrate. In *Armendariz*, "the California Supreme Court held that more than one unlawful provision in an arbitration agreement weighs against severance," *Fitz v. NCR Corp.*, 13 Cal. Rptr. 3d 88, 106 (Cal. Ct. App. 2004), because where an "arbitration agreement," but not any other contract, "contains more than one unlawful provision," that in and of itself "indicate[s] a systematic effort to impose arbitration on an employee not simply as an alternative to litigation, but as an inferior forum that works to the employer's advantage." *Armendariz*, 6 P.3d at 696-97. Therefore, a California court can, on that basis alone, find the entire agreement permeated by an unlawful purpose.

Following the lead of *Armendariz*, the California courts have for 15 years repeatedly found that

the existence of two or more "defects" in an arbitration agreement is per se "a circumstance considered by [the California] Supreme Court to 'permeate' the agreement with unconscionability." *Trivedi v. Curexo Tech. Corp.*, 116 Cal. Rptr. 3d 804, 813 (Cal. Ct. App. 2010). The courts candidly admit that while severance is appropriate "where only one clause in an arbitration agreement [is] found to be substantively unconscionable," it is "not appropriate" where "multiple provisions" are found substantively unconscionable. *Pinela v. Neiman Marcus Grp., Inc.*, 190 Cal. Rptr. 3d 159, 183-84 (Cal. Ct. App. 2015), *reh'g denied* (July 29, 2015), *review denied*, 2015 Cal. LEXIS 6186 (Sept. 16, 2015). The *Armendariz* rule persists even in cases such as this one, where the parties agree to a severability clause expressing their clear intent to have any invalid terms excised from the agreement.

The *Armendariz* multiple-defects rule is not a general principle of California contract law; instead, it is unique and adverse to arbitration agreements. First, it applies only to agreements to arbitrate—it has never been applied to evaluate the enforceability of any other type of contract. Second, it sets a much lower bar for declining to enforce arbitration agreements than contracts generally.

C. At bottom, the *Armendariz* multiple-defects rule is grounded in the assumption that arbitration is an "inferior" mechanism for dispute resolution. *Armendariz* repeatedly highlights what it sees as the "potential disadvantages" and "inherent shortcomings of arbitration." 6 P.3d at 690-91. The entire premise of *Armendariz* is that arbitration agree-

ments are inherently suspect and that illegal or unconscionable provisions in an arbitration agreement are somehow more egregious than in other contracts. And *Armendariz* is not the first or only time the California Supreme Court has expressed hostility to arbitration. Instead, the court is notorious for imposing conditions on the enforcement of arbitration agreements that do not apply to contracts generally, and that reflect ongoing and repeated hostility towards arbitration.

III. California's discriminatory severance rule is preempted by the FAA. No similar rule applies to contracts generally. There is no rule that more than one unconscionable or illegal provision in any other contract indicates a systematic effort to take advantage of the weaker party, and therefore automatically allows a court to throw out the entire contract as permeated by an unlawful purpose. The multiple-defects rule holds agreements to arbitrate invalid on grounds that do not exist for the revocation of any contract. It construes agreements to arbitrate different from nonarbitration agreements, and singles out arbitration agreements for suspect treatment. Thus, as Judge Gould correctly concluded, it is preempted by the FAA. Pet. App. 8a.

This is especially clear for a contract with a severability clause. The FAA embodies an overarching federal policy of enforcing agreements to arbitrate according to their terms. Where parties include severability clauses, they obviously intend for any unenforceable provisions to be severed. California courts recognize that when it comes to contracts generally, but not when it comes to arbitration

agreements. And the district court and Ninth Circuit ignored the severability clause in this case altogether. The judgment of the Ninth Circuit must therefore be reversed.

ARGUMENT

The FAA broadly preempts all state-law rules unique and hostile to agreements to arbitrate. § I. California courts apply one severability rule to contracts in general, favoring contract enforcement and severing invalid terms whenever possible. But California courts improperly apply a different, hostile rule to agreements to arbitrate—a rule favoring the nonenforcement of such agreements. In agreements to arbitrate, but not in other contracts, the mere fact of multiple defects allows a court to hold the entire arbitration agreement invalid, without any case-specific analysis of whether the unenforceable terms truly permeate the contract or whether they can be severed, leaving behind a fully functional arbitration agreement. § II. The California arbitration-only severance rule is unquestionably hostile to arbitration agreements and is preempted by the FAA. § III.

I. The FAA Preempts State Laws Unique And Hostile To Arbitration.

A. The FAA reflects an emphatic federal policy favoring arbitration.

"The FAA was enacted in 1925 in response to widespread judicial hostility to arbitration agreements." *Concepcion*, 131 S. Ct. at 1745. For centuries, English and American courts routinely refused

to enforce agreements to arbitrate. Their hostility "manifested itself in 'a great variety' of 'devices and formulas' declaring arbitration against public policy." *Id.* at 1747 (quoting *Robert Lawrence Co. v. Devonshire Fabrics, Inc.*, 271 F.2d 402, 406 (2d Cir. 1959)). Some devices were explicit. Under the "ouster" doctrine, for example, courts held arbitration agreements "void as an attempt to oust the courts of jurisdiction." *Lewis v. Bhd. Accident Co.*, 194 Mass. 1, 4 (1907); *see also Cal. Annual Conference of Methodist Episcopal Church v. Seitz*, 15 P 839, 841 (1887); *Bozeman v. Gilbert*, 1 Ala. 90, 91 (1840); H.R. Rep. No. 96, 68th Cong., 1st Sess., 1-2 (1924) ("[C]enturies ago, because of the jealousy of the English courts for their own jurisdiction, they refused to enforce specific agreements to arbitrate[.] This jealousy survived for so long a period that the principle became firmly embedded in the English common law and was adopted with it by the American courts."). Thus, in 1874, this Court held that although a person "may submit his particular suit by his own consent to an arbitration .... agreements in advance to oust the courts of the jurisdiction conferred by law are illegal and void." *Home Ins. Co. of N.Y. v. Morse*, 87 U.S. 445, 451 (1874).

Other forms of hostility toward arbitration agreements were couched in generally applicable principles. If arbitration agreements were treated as binding, courts reasoned, "the strong could oppress the weak, and in effect so nullify the law as to secure the enforcement of contracts usurious, illegal, immoral, or contrary to public policy." *Parsons v. Ambos*, 121 Ga. 98, 101 (1904); *see also* Arbitration of Interstate Commercial Disputes: Joint Hearings on

S. 1005 and H.R. 646 Before the Subcomms. of the Comms. on the Judiciary, 68th Cong. 15 (1924) (statement of Julius Henry Cohen, Member, Bar Ass'n Comm. on Commerce, Trade & Commercial Law; General Counsel, N.Y. State Chamber of Commerce) (stating that the "real fundamental cause" of judicial hostility to arbitration agreements "was that ... people were not able to take care of themselves in making contracts, and the stronger men would take advantage of the weaker, and the courts had to come in and protect them").

Formal legislative efforts to overrule judicial hostility to arbitration began in earnest in the early twentieth century, culminating in the passage of the Federal Arbitration Act of 1925. 9 U.S.C. §§ 1-16. "The FAA was enacted as remedial legislation intended to thwart judicial hostility to arbitration and force courts to assess the enforceability of arbitration agreements just as they do all other contractual provisions." Michael G. McGuinness & Adam J. Karr, *California's "Unique" Approach To Arbitration: Why This Road Less Traveled Will Make All The Difference On The Issue Of Preemption Under The Federal Arbitration Act*, 2005 J. Disp. Resol. 61, 65 (2005).

The FAA "reflects an emphatic federal policy in favor of arbitral dispute resolution." *Marmet Health Care Ctr., Inc. v. Brown*, 132 S. Ct. 1201, 1203 (2012) (per curiam) (citation and internal quotation marks omitted). It also "reflects the overarching principle that arbitration is a matter of contract." *Am. Express Co. v. Italian Colors Rest.*, 133 S. Ct. 2304, 2309 (2013).

Section 2, the Act's "centerpiece provision," *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth*, 473 U.S. 614, 625 (1985), declares that:

> A written provision in ... a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction ... shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.

9 U.S.C. § 2.

Consistent with the text of § 2, "courts must 'rigorously enforce' arbitration agreements." *Am. Express Co.*, 133 S.Ct. at 2309 (quoting *Dean Witter Reynolds Inc. v. Byrd*, 470 U.S. 213, 221 (1985)). Moreover, the FAA "creat[es] a body of federal substantive law of arbitrability" that is "applicable to any arbitration agreement within the coverage of the act." *Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 24 (1983). Section 2's reach is "expansive[,]...coinciding with that of the Commerce Clause." *Allied-Bruce Terminix Cos. v. Dobson*, 513 U.S. 265, 274 (1995); *see also Circuit City Stores, Inc. v. Adams*, 532 U.S. 105, 111-121 (2001); *Southland Corp.*, 465 U.S. at 12. The substantive law established by the FAA applies in state and federal court alike, and the FAA has broad preemptive force. *Southland Corp.*, 465 U.S. at 12.

"The 'principal purpose' of [§ 2 of] the FAA is

to 'ensur[e] that private arbitration agreements are enforced according to their terms.'" *Concepcion*, 131 S. Ct. at 1748 (quoting *Volt Info. Scis. v. Bd. of Trs.*, 489 U.S. 468, 478 (1989)). Accordingly, while "§ 2's saving clause preserves generally applicable contract defenses, nothing in it suggests an intent to preserve state-law rules that stand as an obstacle to the accomplishment of the FAA's objectives." *Id.* Instead, "Section 2 is a congressional declaration of a liberal federal policy favoring arbitration agreements, notwithstanding any state substantive or procedural policies to the contrary." *Moses H. Cone*, 460 U.S. at 24. That liberal policy is reinforced by § 4 of the FAA, which states that "the court shall make an order directing the parties to proceed to arbitration in accordance with the terms of the agreement" unless "the making of the agreement" to arbitrate is challenged. 9 U.S.C. § 4.

B. The FAA preempts state-law rules that discriminate against and disfavor arbitration.

The FAA broadly preempts three different types of state laws. *First*, "when state law prohibits outright the arbitration of a particular type of claim, the analysis is straightforward: The conflicting rule is displaced by the FAA." *Concepcion*, 131 S. Ct. at 1747. This Court has thus held that the FAA preempts a California rule prohibiting arbitration of wage disputes. *See Perry v. Thomas*, 482 U.S. 483, 491 (1987).

Second, generally applicable state-law rules that require "procedures that are incompatible with

arbitration" are also preempted. *See Concepcion*, 131 S. Ct. at 1748 (citation omitted). This Court therefore struck down a California common law rule "requiring the availability of classwide arbitration" because it "interfere[d] with fundamental attributes of arbitration." *Id.*

Third, and most relevant here, the FAA preempts state rules, whether codified in legislation or a creation of common law, that treat agreements to arbitrate differently than other contracts. *See* 9 U.S.C § 2; *Preston v. Ferrer*, 552 U.S. 346, 356 (2008). Simply stated, state courts may not discriminate against arbitration agreements and may not single "out arbitration provisions for suspect status." *Doctor's Assocs. Inc. v. Casarotto*, 517 U.S. 681, 687 (1996).

As this Court explained in *Perry v. Thomas*, "state law ... is applicable *if* that law arose to govern issues concerning the validity, revocability, and enforceability of contracts generally." 482 U.S. at 492 n.9 (emphasis in original). But "[a] state law principle that takes its meaning precisely from the fact that a contract to arbitrate is at issue" does not comport with the plain language of § 2 of the FAA. *Id.* Hence a court may neither construe an arbitration agreement "in a manner different from that in which it otherwise construes nonarbitration agreements under state law," *id.*, nor "rely on the uniqueness of an agreement to arbitrate as a basis for a state-law holding that enforcement would be unconscionable[.]" *Id.* It is irrelevant whether the discriminatory state-law rule is "of legislative or judicial origin"—otherwise a court would be able to "effect what ... the

state legislature cannot." *Id.* The same is true "when a doctrine normally thought to be generally applicable, such as ... unconscionability" is "applied in a fashion that disfavors arbitration." *Concepcion*, 131 S. Ct. at 1747-48. Thus, courts may not apply state-law doctrines of general applicability in ways that subject arbitration clauses to disfavored treatment. *Id.* "That a state decision employs a general principle of contract law, such as unconscionability, is not always sufficient to ensure that the state-law rule is valid under the FAA. Even when using doctrines of general applicability, state courts are not permitted to employ those general doctrines in ways that subject arbitration clauses to special scrutiny." *Iberia Credit Bureau, Inc. v. Cingular Wireless LLC*, 379 F.3d 159, 167 (5th Cir. 2004).

This Court has accordingly struck down state-law rules that impose special barriers on the enforcement of arbitration agreements or assess the enforceability of arbitration provisions according to rules that do not apply to contracts generally. In *Preston v. Ferrer*, this Court struck down a California statute that permitted the arbitration of disputes between artists and "talent agents" only if the State Labor Commissioner was provided with notice and an opportunity to attend all arbitration hearings. 552 U.S. at 355-56. This Court easily concluded that such a requirement stood in "conflict with the FAA's dispute resolution regime" because it "impose[d] prerequisites to enforcement of an arbitration agreement that [were] not applicable to contracts generally." *Id.* at 356 (citing *Doctor's Associates*, 517 U.S. at 687).

Similarly, in *Doctor's Associates*, a Montana statute required that "[n]otice that [the] contract is subject to arbitration" be "typed in underlined capital letters on the first page of the contract." 517 U.S. at 683 (citation and internal quotation marks omitted). The Court held that "Montana's first-page notice requirement, which governs not 'any contract,' but specifically and solely contracts 'subject to arbitration,' conflicts with the FAA," and was therefore preempted. *Id.*

The Court began by observing that, although § 2's savings clause preserves generally applicable contract defenses, "[c]ourts may not ... invalidate arbitration agreements under state laws applicable *only* to arbitration provisions." *Id.* at 687. Section 2 "preclude[s] States from singling out arbitration provisions for suspect status, requiring instead that such provisions be placed 'upon the same footing as other contracts.'" *Id.* (quoting *Scherk v. Alberto-Culver Co.*, 417 U.S. 506, 511 (1974)). Here, the Montana law conditioned the enforceability of agreements to arbitrate on compliance with special "requirement[s] not applicable to contracts generally," placing agreements to arbitrate "in a class apart from 'any contract." *Id.* at 687-88. It was therefore preempted by the FAA.

Taken together, this Court's decisions stand for the unqualified proposition that state courts may not impose heightened standards or rules on arbitration agreements or treat such agreements as a suspect class. Instead, only generally applicable contract defenses, that are applied in the same way for agreements to arbitrate as for contracts in gen-

eral, survive § 2. This anti-discrimination principle stands at the core of the FAA.

II. California Courts Embrace A Severability Rule Unique And Hostile To Arbitration Agreements.

A. For contracts generally, California courts exhibit a strong preference for severing unenforceable terms and enforcing the remaining agreement.

Like most states, California generally expresses an overwhelming preference for contract enforcement. California law generally prohibits a court from voiding a contract unless the entire purpose of the contract is unlawful. This longstanding common law rule was codified by statute in 1872: "Where a contract has but a single object, and such object is unlawful ... the entire contract is void." Cal. Civil Code § 1598. The statute continues, "[w]here a contract has several distinct objects, of which one at least is lawful, and one at least is unlawful, in whole or in part, the contract is void as to the latter and valid as to the rest." *Id.* at § 1599. When California codified the common law doctrine of unconscionability in 1979, it included a similar provision. *See id.* at § 1670.5 ("If the court as a matter of law finds the contract or any clause of the contract to have been unconscionable at the time it was made the court may refuse to enforce the contract, or it may enforce the remainder of the contract without the unconscionable clause, or it may so limit the application of

any unconscionable clause as to avoid any unconscionable result.").

California courts have thus consistently applied a strong preference for severance if possible, even "when the parties have contracted, in part, for something illegal." *Marathon Entm't, Inc. v. Blasi*, 174 P.3d 741, 750 (Cal. 2008). "Notwithstanding any such illegality," California generally "preserves and enforces any lawful portion of a parties' contract that feasibly may be severed." *Id.* at 750-51.

In deciding whether to sever illegal or unconscionable provisions in contracts generally, courts "look to the various purposes of the contract." *Id.* at 754 (citation omitted). The severability inquiry is "equitable and fact specific," and requires "case-by-case consideration" of whether severing the unenforceable terms is appropriate and feasible. *Id.* at 755. "If the illegality is collateral to the main purpose of the contract, and the illegal provision can be extirpated from the contract by means of severance or restriction, then such severance and restriction are appropriate." *Id.* at 754 (citation omitted). If, on the other hand, "the court is unable to distinguish between the lawful and unlawful parts of the agreement, the illegality taints the entire contract, and the entire transaction is illegal and unenforceable." *Birbrower, Montalbano, Condon & Frank v. Super. Ct.*, 949 P.2d 1, 12 (Cal. 1998) (citation and internal quotation marks omitted). Severance is thus appropriate unless "the central purpose of the contract is tainted with illegality." *Marathon*, 174 P.3d at 754 (citation omitted).

In *Mailand v. Burckle*, the California Supreme Court held that two separate provisions in a franchise agreement violated state antitrust laws. One provision allowed defendants to set the price of gasoline that plaintiffs sold; another required plaintiffs to purchase gasoline from a particular company. 572 P.2d 1142, 1144-45, 1152 (Cal. 1978). Yet the court expressly rejected "defendants' assertion that the entire franchise agreement must be declared void," relying on the settled rule "that partially illegal contracts may be upheld if the illegal portion is severable from the part which is legal." *Id.* at 1152. Because both illegal provisions could be severed "without undermining the essential objects of the agreement," the court refused to throw out the entire agreement. *Id.*

Similarly, in *A&M Produce Co. v. FMC Corp.*, the trial court ruled that two provisions, a waiver of warranties and an exclusion of consequential damages, were unconscionable. 186 Cal. Rptr. 114, 119-26 (Cal. Ct. App. 1982). Yet instead of throwing out the contract altogether, the trial court refused to enforce those two unconscionable provisions. *Id.* at 118-19. The Court of Appeals affirmed. *Id.* at 125-26; *see also Ilkhchooyi v. Best*, 45 Cal. Rptr. 2d 766, 776 (Cal. Ct. App. 1995) (where the trial court found that a profit-shifting clause was unconscionable, "the trial court had the power to strike that portion" of the lease; no discussion whatsoever of any power to refuse to enforce the entire contract).

Even where a contract appears to be indivisible, there is still a policy favoring severance. "California cases take a very liberal view of severability,

enforcing valid parts of an apparently indivisible contract where the interests of justice or the policy of the law would be furthered." *In re Marriage of Facter*, 152 Cal. Rptr. 3d 79, 95 (Cal. Ct. App. 2013) (quoting *Adair v. Stockton Unified Sch. Dist.*, 77 Cal. Rptr. 3d 62, 73 (Cal. Ct. App. 2008)). In *Birbrower*, the defendant law firm practiced law in California without a license. Although "substantial legal services" under the agreement had been performed illegally in California, the California Supreme Court held that the Court of Appeals erred in throwing out the entire agreement. Instead, if the law firm could prove that it generated fees for the "limited services" it provided legally in New York, it could recover those fees. 949 P.2d at 2-3, 12-13.

California courts have even rewritten contracts to avoid throwing them out entirely. For example, in *Carboni v. Arrospide*, 2 Cal. Rptr. 2d 845, 849 (Cal. Ct. App. 1991), the trial court held that a short term loan with an interest rate of 200% was substantively unconscionable. Yet instead of refusing to enforce the loan agreement altogether, the Court allowed interest at a rate of 24%, the "then prevailing [rate] in the credit market for similar loans." *Id.* at 846-47, 849. The Court of Appeals affirmed. *Id.* at 851.

Moreover, California courts generally show great respect for express severability clauses, respecting the parties' intent that unenforceable terms be severed while the rest of the agreement remains in force. In *California School Employees Ass'n v. Del Norte County Unified School District*, 4 Cal. Rptr. 2d 35 (Cal. Ct. App. 1992), a school district entered into

a contract with a private corporation to, among other things, supervise its custodial and maintenance employees. The trial court ruled that those portions of the contract violated the State Education Code. *Id.* at 36-37. The issue of severability had not been briefed, but the contract at issue contained an express severability clause, showing that "the parties clearly intended [the contract] to be severable." *Id.* at 37. In light of the clause, the Court held that only "those aspects of the contract that provide for ... regular supervision of employees, including ... giving orders to such employees, setting work schedules, authorizing overtime, approving timesheets," etc., were invalid and needed to be eliminated from the contract. *Id.* 37-38. As to other "services not specifically prohibited ... above," the contract continued and remained in force. *Id.* at 38.

Thus, for contracts generally, California law expresses an overwhelming preference for contract enforcement, and will generally sever any illegal or unconscionable provisions that can be feasibly severed.

B. For agreements to arbitrate, California courts apply a different rule, disfavoring severance.

In stark contrast, California courts have long applied a different rule, favoring the non-enforcement of agreements to arbitrate. In *Armendariz*, "the California Supreme Court held that more than one unlawful provision in an arbitration agreement weighs against severance." *Fitz*, 13 Cal. Rptr. 3d at 106 (refusing to sever two unconscionable

provisions, a limitation on discovery and an exemption from arbitration for disputes over confidentiality agreements and intellectual property rights). According to the California Supreme Court, where an "arbitration agreement," but not any other contract, "contains more than one" provision deemed unlawful or unconscionable by a court, that in and of itself "indicate[s] a systematic effort to impose arbitration on an employee not simply as an alternative to litigation, but as an inferior forum that works to the employer's advantage." *Armendariz*, 6 P.3d at 696-97. Therefore, a California court may, based only on there being two or more unenforceable terms, presume that the entire arbitration agreement is "permeated by an unlawful purpose" and simply refuse to enforce it. *Id.* at 697

Unsurprisingly, California courts of appeals have interpreted and applied *Armendariz* for the least 15 years to mean exactly what it says—the existence of even two substantively unconscionable provisions in an arbitration agreement is "a circumstance considered by [the California] Supreme Court to 'permeate' the agreement with unconscionability." *Trivedi*, 116 Cal. Rptr. 3d at 813. Or, in other words, "[a]n employment arbitration agreement can be considered permeated by unconscionability if it contains more than one unlawful provision." *Murphy v. Check 'N Go of Cal., Inc.*, 67 Cal. Rptr. 3d 120, 128-29 (Cal. Ct. App. 2007), as modified (Nov. 9, 2007) (citation and internal quotation marks omitted).

California courts of appeals candidly admit the mechanical nature of this arbitration-only rule. While severance is appropriate "where only one

clause in an arbitration agreement [is] found to be substantively unconscionable," it is "not appropriate" where "multiple provisions" are found unconscionable. *Pinela*, 190 Cal. Rptr. 3d at 183-84.

Often, the courts simply quote the language from *Armendariz* and summarily refuse to sever, without any of the detailed scrutiny of whether severance is appropriate and feasible that is required in other contexts. *See, e.g., Martinez v. Master Prot. Corp.*, 12 Cal. Rptr. 3d 663, 673 (Cal. Ct. App. 2004); *Ontiveros v. DHL Exp. (USA), Inc.*, 79 Cal. Rptr. 3d 471, 488-89 (Cal. Ct. App. 2008); *Lhotka v. Geographic Expeditions, Inc.*, 104 Cal. Rptr. 3d 844, 852-53 (2010). For example, in *Trivedi*, the court of appeals found two provisions in an arbitration agreement unconscionable: a provision allowing the prevailing party to recover attorney's fees, and a provision allowing both parties to seek provisional injunctive relief in court while arbitration proceedings were pending. 116 Cal. Rptr. 3d at 809-11. The court refused to sever because "an arbitration agreement can be considered permeated by unconscionability if it 'contains more than one unlawful provision.... Such multiple defects indicate a systematic effort to impose arbitration ... not simply as an alternative to litigation, but as an inferior forum that works to the [stronger party's] advantage." *Id.* at 812 (citations omitted).

In *Pinela*, likewise, the court's severance discussion was perfunctory, with no actual feasibility analysis. The court stated, in total:

> Severance was the correct solution in *Serafin* [*v. Balco Properties Ltd., LLC*, 185 Cal. Rptr. 3d 151, 160 (Cal. Ct. App. 2015)], where only one clause in an arbitration agreement was found to be substantively unconscionable, but in light of our determination that multiple provisions of the NMG Arbitration Agreement are substantively unconscionable here, we conclude that severance of the offending provisions is not appropriate. (*See Carmona v. Lincoln Millennium Car Wash, Inc.* (2014) 226 Cal. App. 4th 74, 90, 171 Cal. Rptr. 3d 42 ["When an arbitration agreement contains multiple unconscionable provisions, '[s]uch multiple defects indicate a systematic effort to impose arbitration on an employee not simply as an alternative to litigation, but as an inferior forum that works to the employer's advantage'"].) The unconscionability we have found permeates the NMG Arbitration Agreement to such a degree that severance would amount to re-writing the parties' contract, something we cannot do.

190 Cal. Rptr. 3d at 183-84.

Similarly, in *Martinez* the court found a cost-sharing provision; a provision exempting from arbitration claims for unfair competition, misuse of con-

fidential information, and trade secrets; and a shortened limitations period unconscionable. The court of appeals held that the trial court erred in granting the motion to compel arbitration:

> Such multiple defects indicate a systematic effort to impose arbitration on an employee ... as an inferior forum that works to the employer's advantage." [citing *Armendariz*]. The substantively unconscionable provisions cannot be cured by striking or limiting application of identifiable provisions. Rather, the arbitration agreement is so permeated by unconscionability [it] could only be saved, if at all, by a reformation beyond our authority.

12 Cal. Rptr. 3d at 673 (internal quotation marks and citations omitted).

Wherry v. Award, Inc. refused to enforce an arbitration agreement that the plaintiffs signed as part of an agreement to work as independent contractors for a real estate company. 123 Cal. Rptr. 3d 1, 6-7 (Cal. Ct. App. 2011). The unconscionable provisions included a clause allowing the arbitrator to award costs to the prevailing party, a clause awarding attorney fees to the prevailing party, and a shortened limitations period. *Id.* at 6-7. The court noted that "the general rule does favor arbitration." *Id.* at 8. However, it quoted the *Armendariz* multiple-defects rule, and summarily held that "[h]ere, based on the several unconscionable provisions de-

tailed above the arbitration agreement is so permeated by unconscionability [it] could only be saved, if at all, by a reformation beyond our authority." *Id.* at 7 (citations and internal quotation marks omitted). It therefore refused to sever. *Id. See also Pinedo v. Premium Tobacco Stores*, 102 Cal. Rptr. 2d 435, 440 (Cal. Ct. App. 2000) (refusing to sever and quoting *Armendariz's* multiple-provisions language); *Carmona*, 171 Cal. Rptr. 3d at 55 (same); *Mayers v. Volt Mgmt. Corp.*, 137 Cal. Rptr. 3d 657, 670 (Cal. Ct. App. 2012), *as modified on denial of reh'g* (Feb. 27, 2012), *review granted and opinion superseded*, 278 P.3d 1167 (Cal. 2012), *review dismissed*, 356 P.3d 776 (Cal. 2015) (§ 1670.5(a) "authorizes a trial court to refuse to enforce an entire agreement it finds 'permeated' by unconscionability because ... it 'contains more than one unlawful provision.'" (citation omitted)).

Armendariz's arbitration-only anti-severance rule endures notwithstanding this Court's most recent explanation of the broad preemptive force of the FAA. Indeed, it endures even in cases in which the defendant argued that the FAA preempts state-law rules that disfavor arbitration.

For example, in *Samaniego*, 140 Cal. Rptr. 3d at 501, the appellant argued that *Concepcion* preempted each "unconscionability-based rationale that supported the trial court's refusal to compel arbitration." The court of appeals disagreed, quoting *Concepcion* for the proposition that the FAA "permits agreements to arbitrate to be invalidated by generally applicable contract defenses, such as fraud, duress, or unconscionability, although not by

defenses that apply only to arbitration or that derive their meaning from the fact that an agreement to arbitrate is at issue." *Id.* at 502 (quoting 131 S. Ct. at 1746) (internal brackets and quotation marks omitted). In the same breath, however, the Court held that the trial court did not abuse its discretion in refusing to sever the "carve-out" for injunctive and declaratory relief, fee-shifting provisions and shortened limitations period because "[a]n arbitration agreement can be considered permeated by unconscionability if it contains more than one unlawful provision." *Id.* at 501 (citations and internal quotation marks omitted).

Finally, the *Armendariz* rule persists even in cases, such as this one, where the parties agreed to a severability clause expressing their clear intent to have the agreement enforced with any invalid terms excised. *Parada v. Super. Ct.* considered an arbitration agreement that expressly stated: "[i]n the event that any provision of this Agreement shall be determined by a trier of fact of competent jurisdiction to be unenforceable . . . the remainder of this Agreement shall remain binding upon the parties as if such provision was not contained herein." 98 Cal. Rptr. 3d 743, 753 (Cal. Ct. App. 2009). Yet the court completely ignored this unambiguous severance clause, refusing to sever because "a court may refuse to sever a contract provision with multiple unconscionable terms." *Id.* at 769 (quoting *Armendariz*, 6 P.3d at 696-97).

In sum, the *Armendariz* multiple-provisions rule is not a general principle of California contract law; instead, it sets a much lower bar for declining to

enforce arbitration agreements than contracts generally. Moreover, the rule has been applied over the last 15 years *only* to agreements to arbitrate; it has never been applied to evaluate the enforceability of any other type of contract. This is so because *Armendariz* itself assumes that illegal or unconscionable provisions in an arbitration agreement are somehow more egregious than in other contracts and warrant a per se decision to void the agreement.

C. California's multiple-unlawful-provisions rule is rooted in hostility to arbitration.

As discussed, for contracts in general, having two terms deemed unlawful or unconscionable does not displace California's strong presumption in favor of severance, or negate the obligation of a court to carefully examine whether severing the unenforceable terms is feasible and appropriate. The different approach embraced as to arbitration agreements was the result of a deep judicial antagonism to arbitration as an inferior forum for resolving disputes.

The *Armendariz* court went into detail about the basis for its skepticism of arbitration as an inferior forum. The Court highlighted, repeatedly, what it viewed as the "potential disadvantages" and "inherent shortcomings of arbitration." 6 P.3d at 690-91. These included limited discovery, limited judicial review, and limited procedural protections. *Id.* at 690-91. Moreover, the court noted, private arbitration may "become an instrument of injustice," *id.* at 690, not only as to process but as to result. In addition to sacrificing procedural protections, arbitration

generally "reduces the size of the award that an employee is likely to get." *Id.* And "courts and juries are viewed as more likely" than arbitrators "to adhere to the law," and "less likely than arbitrators to 'split the difference' between the two sides." *Id.* at 693.

The court made clear that its negative view of arbitration was going to have real world consequences. Noting that statutory rights "need ... a public, rather than private, mechanism of enforcement," the court declared that it must subject arbitration agreements purporting to cover unwaivable statutory rights to "*particular scrutiny*." *Id.* at 680-81 (emphasis added).

With that preface, the California Supreme Court formulated five minimum, per se "requirements for the lawful arbitration" of statutory rights by employees. First, the arbitration agreement must provide for neutral arbitrators. *Id.* at 682. Second, employees must be allowed "adequate discovery." *Id.* at 683-84. Third, the agreement must guarantee a "written arbitration decision" and "adequate judicial review." *Id.* at 685. Fourth, "all of the types of relief that would otherwise be available in court" must be available to the employee. *Id.* at 682-83. Fifth, the employee may not be required to "bear any type of expense that [he or she] would not be required to bear if he or she were free to bring the action in court." *Id.* at 687-88.

Although couched in terms of unconscionability, these five categorical, per se requirements do not

apply to contracts in general. Instead they apply exclusively to agreements to arbitrate.[2] And this is not the first time that the California Supreme Court has expressed hostility to arbitration. Instead, the California Supreme Court is notorious for imposing conditions on the enforcement of arbitration agreements that do not apply to contracts generally, and that reflect ongoing and repeated hostility towards arbitration.[3]

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[2] Several of these per se rules are likely preempted by the FAA. To take one example, *Armendariz* holds that employees may not be required to "bear any *type* of expense that [he or she] would not be required to bear" in court. *Id.* at 687-88. The court expressly disapproved of requiring a party to prove that she actually was or would be exposed to unaffordable costs, because "it is not only the costs imposed on the claimant[,] but the *risk* that the claimant may have to bear substantial costs that deters the exercise of the" plaintiff's statutory rights. 6 P.3d at 687. That is precisely the opposite of this Court's holding, two months later, in *Green Tree Financial Corp.-Alabama v. Randolph*, 531 U.S. 79 (2000). In *Green Tree*, the plaintiff argued that an arbitration agreement that did not specify who would bear arbitration costs was unenforceable because it created a risk that she would have to bear substantial costs, potentially leaving her unable to effectively vindicate her statutory rights. The Court rejected the contention, explaining that a party seeking to avoid enforcement of an arbitration agreement on the basis of costs "bears the burden" of proving "the likelihood of incurring" costs that would actually thwart vindication of her statutory rights. *Id.* at 91-92.

[3] *See, e.g. Broughton v. Cigna Healthplans of Cal.*, 988 P.2d 67, 76-79 (Cal. 1999) (prohibiting arbitration of claims for injunctive relief under California's Consumers Legal Remedies Act because of the "evident institutional shortcomings of private arbitration in the field of ... public injunctions" and

Thus, in creating the rule at issue here, the California Supreme Court made clear, repeatedly, that it believes arbitration is an inferior method of adjudicating disputes and warrants a heavy dose of judicial skepticism and scrutiny.

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because "superior court judges are accountable to the public in ways arbitrators are not"); *Cruz v. PacifiCare Health Sys., Inc.*, 66 P.3d 1157, 1164-65 (Cal. 2003) (extending *Broughton* to prohibit arbitration of claims for injunctive relief under California's unfair competition and misleading advertising laws because those actions are "undertaken for the public benefit" and there is thus an "inherent conflict" with arbitration); *Ferrer v. Preston*, 51 Cal. Rptr. 3d 628, 631, 634 (Cal. Ct. App. 2007) (refusing to enforce arbitration agreement because California's Talent Agencies Act "vests exclusive original jurisdiction in the [Labor] Commissioner to resolve issues arising under the Act"), *rev'd*, 552 U.S. 346 (2008); *Sonic-Calabasas A, Inc. v. Moreno*, 247 P.3d 130, 139-146 (Cal. 2011) (invalidating, as contrary to public policy and unconscionable, a provision in an arbitration agreement that waived a "*Berman* hearing" before the California Labor Commissioner for an unpaid wage claim, because the *Berman* hearing "provides on the whole substantially lower costs and risks to the employee, greater deterrence of frivolous employer claims, and greater assurance that awards will be collected, than does the binding arbitration process alone" and "the benefits the employee gains from arbitration" do not compensate "for what he or she loses by forgoing the option of a *Berman* hearing"), *vacated*, 132 S. Ct. 496 (2011) (mem.).

III. California's Multiple-Unlawful-Provisions Rule, Uniquely Applied To Arbitration Agreements, Is Preempted By The FAA.

As discussed, for 15 years the California courts have applied the *Armendariz* multiple-provisions rule to hold agreements to arbitrate invalid on grounds that do not apply to contracts generally. For contracts generally, California law expresses an overwhelming preference for contract enforcement, and California courts will generally sever any illegal or unconscionable provisions that can be feasibly severed. *Supra*, § II.A. But for arbitration contracts, California courts apply a different analysis, one that expressly applies only to agreements to arbitrate and favors invalidating such agreements, rather than severing out any objectionable provisions. *Supra*, § II.B. As detailed above, that arbitration-only anti-severance rule is rooted in an antagonistic view of arbitration as an inferior forum for dispute resolution, and arbitration agreements as requiring particular scrutiny. *Supra*, § II.C.

Under the *Armendariz* multiple-unlawful-provisions rule, the mere presence of more than one unconscionable provision allows a Court to throw out the entire arbitration agreement because where an "arbitration agreement contains more than one unlawful provision," that in and of itself "indicate[s] a systematic effort to impose arbitration on an employee not simply as an alternative to litigation, but as an inferior forum that works to the employer's advantage" and allows a court to conclude that the "arbitration agreement is permeated by an unlawful

purpose." *Armendariz*, 6 P.3d at 696-97. No similar rule applies to contracts generally. There is no rule that more than one unconscionable provision in any other type of contract indicates a systematic effort to take advantage of the weaker party, and therefore automatically allows a court to throw out the entire contract as permeated by an unlawful purpose.

The multiple-unlawful-provisions rule—which applies only to arbitration agreements—is therefore preempted by the FAA. The rule treats agreements to arbitrate "in a manner different from that in which it otherwise [treats] nonarbitration agreements under state law." *Perry*, 482 U.S. at 492 n.9. It "singl[es] out arbitration provisions for suspect status." *Doctor's Assocs.*, 517 U.S. at 687 It "takes its meaning precisely from the fact that a contract to arbitrate is at issue" by expressly stating that multiple unlawful provisions in an agreement to arbitrate, but not any other contract, indicate an unlawful purpose. And it "rel[ies] on the uniqueness of an agreement to arbitrate as a basis for a state-law holding that enforcement would be unconscionable[,]" because in no other contract setting do two or more unconscionable provisions automatically allow a court to throw out the entire agreement. *Concepcion*, 131 S. Ct. at 1746-47 (quoting *Perry*, 482 U.S. at 493 n.9). For all the reasons set forth above, it cannot be sustained under the FAA or this Court's precedents, and the court of appeals and district court's rulings here premised on the *Armendariz* rule must be reversed.

As Judge Gould explained, "the district court's decision not to sever the unconscionable provisions of

the arbitration agreement relying on *Armendariz* is ... based on an erroneous interpretation and an inaccurate view of *Concepcion* and the FAA." Pet. App. 11a. Specifically, "[t]he reasoning in *Armendariz* that multiple unconscionable provisions will render an arbitration agreement's purpose unlawful," so as to presumptively justify refusal to sever, "should have been preempted by the [FAA]." Pet. App. 8a.

This is especially clear for a contract with an express severability clause. The FAA embodies an overarching federal policy "to ensure that private agreements to arbitrate are enforced according to their terms." *Stolt-Nielsen S.A. v. AnimalFeeds Int'l Corp.*, 130 S. Ct. 1758, 1773 (2010) (citation and internal quotation marks omitted). The Agreement in this case contains an express severability clause. Pet. App. 53a-54a ("[I]f any provision of this Agreement is rendered invalid or unenforceable ... the remaining provisions of this Agreement shall remain in full force and effect."). Yet the district court and Ninth Circuit ignored the clause altogether. California courts do the same. As we detailed above (at 38), even in cases with express severability clauses, California courts apply *Armendariz's* multiple-defects rule and refuse to sever unconscionable provisions. *See, e.g., Parada v. Super. Ct.*, 98 Cal. Rptr. 3d at 753 (ignoring an unambiguous severability clause, applying *Armendariz's* multiple-provisions rule, and refusing to sever). Nothing could be further from enforcing arbitration agreements "according to their terms." *Stolt-Nielsen*, 130 S. Ct. at 1773.

Absent the *Armendariz* arbitration-only anti-severance rule, the district court here would have

examined whether severance was feasible and whether the agreement was truly permeated by unconscionability. The district court, relying on *Armendariz*, did not undertake that analysis. Instead, it simply listed the unconscionable provisions, cited *Armendariz*, and concluded that it "could not attempt to ameliorate the unconscionable aspects of the Agreement without being required to assume the role of contract author rather than interpreter." Pet. App. 30a (internal quotation marks omitted). That is false. The American Arbitration Association rules agreed to by the parties, Pet. App. 56a, would fill any gaps that would result from voiding the terms identified by the district court, such as the arbitrator selection procedure. The district court would therefore not be required to cure any omission or "assume the role of contract author," Pet. App. 30a. Indeed, Judge Gould illustrated how easy it would be to excise the challenged provisions and still have a fully viable arbitration agreement—one that preserved the parties' original intent to arbitrate, rather than litigate, their disputes. Pet. App. 8a-10a.

Accordingly, this Court should hold the *Armendariz* rule preempted and direct the district court to sever any unconscionable terms and compel arbitration. In the alternative, the Court may wish to remand to the district court for it to engage in the detailed fact specific, case-by-case severability analysis applied in all other severability contexts, without any special rules or hostility to arbitration.

CONCLUSION

For the reasons set forth above, this Court should hold that California's multiple-unlawful-provisions rule is preempted by the FAA. It should accordingly reverse the judgment of the Ninth Circuit.

Respectfully submitted,

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